



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PAC 730.31/2002-16

December 9, 2002
02-PAC-088(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Extension of Class Deviation from FAR 31.203(c), Indirect Costs

On September 29, 1999, Director, Defense Procurement (DDP) originally issued a class deviation for DoD contracts and subcontracts, effective through September 30, 2002. This deviation was extended on September 9, 2002, effective through September 30, 2005 (see Enclosure). This deviation instructs DoD contracting activities to "deviate from the requirements of FAR 31.203(c) when costs disallowed under FAR 31.205-52 are required to be included in the indirect cost base."

Prior to April 15, 1996, CAS 404 required that tangible capital assets acquired in a business combination under the purchase method of accounting be valued at fair market value. This often resulted in a "step-up amount" (the difference between the fair market value of the assets and the previous book value). FAR 31.205-52 disallows this step-up amount. Under FAR 31.203(c), "all items properly includable in an indirect cost base should bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs." Therefore, the application of the FAR 31.203(c) requirement means that the contractor must include depreciation costs based on the fair market value of the assets in the applicable indirect cost allocation base. The inclusion of depreciation costs based on the fair market value of the assets in the indirect allocation base results in the indirect costs applicable to the disallowed stepped-up depreciation amounts being disallowed as well. Under the deviation granted by DDP, the indirect costs allocable to the stepped-up depreciation amounts will not be disallowed. This deviation applies only to the application of FAR 31.203(c) to costs disallowed under FAR 31.205-52.

This deviation is effective as of September 9, 2002 and applies to all future contracts and open cost-reimbursement contracts for which the final indirect rates were not settled as of September 29, 1999. If an FAO has issued an audit report questioning the indirect cost associated with FAR 31.205-52 unallowable costs and the indirect rates have not yet been settled, the FAO should issue a supplemental audit report implementing this deviation.

PAC 730.31/2002-16

02-PAC-088(R)

December 9, 2002

SUBJECT: Audit Guidance on Extension of Class Deviation from FAR 31.203(c), Indirect Costs

If FAO personnel have any questions, they should contact regional personnel. If regional personnel have any questions they should contact John Shire, Program Manager, Accounting and Cost Principles Division, at (703) 767-3247 or jshire@dcaa.mil.

/Signed/

Robert DiMucci
Assistant Director
Policy and Plans

Enclosure

DDP Memo, dated September 9, 2002

DISTRIBUTION: C



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

SEP 9 2002

DP(CPF)

In reply refer to
DAR Tracking Number: 2002 O0005

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT,
ASN (RD&A)/ABM
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(CONTRACTING), SAF/AQC
ACTING DEPUTY ASSISTANT SECRETARY OF THE ARMY
(POLICY AND PROCUREMENT), ASA(ALT)
EXECUTIVE DIRECTOR, LOGISTICS POLICY AND
ACQUISITION MANAGEMENT (DLA)

SUBJECT: Class Deviation – Federal Acquisition Regulation (FAR) 31.203(c), Indirect
Costs

On September 29, 1999, the Director of Defense Procurement authorized the attached deviation from the requirements of FAR 31.203(c) when costs disallowed under FAR 31.205-52 are required to be included in the indirect cost base. The deviation expires on September 30, 2002. This memorandum extends the deviation until September 30, 2005.

Any questions concerning this memorandum should be addressed to Mr. David Capitano, Senior Procurement Analyst, at 703-602-4245 or via e-mail at: david.capitano@osd.mil.

Deidre A. Lee
Director, Defense Procurement

Attachment:
As stated



Enclosure



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

September 29, 1999

DP(CPF)

In reply refer to
DAR Tracking Number: 99-00009

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT,
ASN(RD&A)/ABM
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(CONTRACTING), SAF/AQC
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
EXECUTIVE DIRECTOR FOR PROCUREMENT MANAGEMENT (DLSC/DLA)

SUBJECT: Class Deviation--Federal Acquisition Regulation (FAR)
31.203(c), Indirect Costs

Effective immediately, all Department of Defense contracting activities shall deviate from the requirements of FAR 31.203(c) when costs disallowed under FAR 31.205-52 are required to be included in the indirect cost base.

Prior to April 15, 1996, the Cost Accounting Standards (CAS) measured, assigned, and allocated the costs of tangible capital assets acquired in a business combination under the purchase method of accounting on the basis of fair market value. This often resulted in an increase in the value of the assets over the pre-business combination book value; the increase is commonly referred to as the step-up amount. FAR 31.205-52 disallowed this step-up amount.

When assets that are valued at fair market value are included as part of the base for allocating indirect costs, CAS requires that indirect expenses be allocated to the entire fair market value, including any step-up amounts. FAR 31.203(c) renders unallowable that share of the indirect expenses that are allocable to the disallowed step-up amount.

The purpose of FAR 31.205-52 is to assure that the amount of depreciation of tangible assets and amortization of intangible assets the Government pays is not increased as a result of a business combination. However, in this situation, contractors should not be penalized by having their indirect cost recovery reduced. Therefore,



Enclosure

I am authorizing a deviation from FAR 31.203(c). The deviation relates only to the application of FAR 31.203(c) to costs disallowed under FAR 31.205-52. Thus, when costs disallowed under FAR 31.205-52 are required to be included in the indirect cost base, the indirect expenses proportionate to those disallowed costs will not be disallowed on the basis of FAR 31.203(c).

This deviation applies to all future contracts. It also applies to indirect rates applicable to open cost-reimbursement contracts, provided that the final indirect rates have not been established (see FAR 42.705) as of the date of this memorandum. The deviation also applies to any other situations requiring that indirect costs be settled before contract prices are established, provided that the final indirect cost rates have not been established (see FAR 42.705) as of the date of this memorandum.

This class deviation is effective through September 30, 2002.



Eleanor R. Spector
Director, Defense Procurement

cc: DSMC, Ft. Belvoir